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Commissioner	:	<u>Simon</u>
ALJ	:	<u>Bushey</u>
Witness	:	<u>Logan</u>



**DIVISION OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION**

**Opening Testimony
on
Joint Utility Application
for the
Proposed Wildfire Expense Balancing Account
(WEBA)**

Pacific Gas and Electric Company
San Diego Gas & Electric Company
Southern California Edison Company
Southern California Gas Company

San Francisco, California
September 12, 2011

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PROPOSED WILDFIRE EXPENSE BALANCING ACCOUNT

I. INTRODUCTION

This testimony presents the analysis and recommendations of the Division of Ratepayer Advocates (DRA) regarding the joint amended and restated testimony submitted by Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (SCE or Edison), and Southern California Gas Company (SoCalGas) for authority to establish a wildfire expense balancing account (WEBA) to record for future recovery wildfire-related costs. The joint amended application was filed in August of 2010, about one year following the original application submittal.

The proposed WEBA, according to the applicants, is intended to reduce the financial uncertainty associated with damaging and costly wildfires which have or could occur in the utilities' respective service territories.¹ The financial uncertainty stems from instances when utility facilities have either caused or are alleged to have caused personal and property damages in excess of (1) utility insurance coverage, or (2) current ratemaking mechanisms. Further, the utilities argue that the legal consequences of "inverse condemnation" exacerbates this financial uncertainty because a utility may be declared responsible for damage claims even in instances when the utility's facilities may not have been the cause of the wildfire ignition or its spread.

Fundamentally, the WEBA would act as a wildfire insurance policy for the utilities once their actual insurance policy limits are exhausted. And in recent years, wildfire liability insurance has become increasingly expensive and decreasingly available, according to the applicants. This testimony addresses the utilities' claims of financial uncertainty, insurance market issues, the regulatory process, and the impact that the WEBA may have on the utility safety program.

¹ DRA understands that the only historical event covered by the proposal is the October 2007 wildfires in San Diego County.

II. RECOMMENDATION

DRA recommends that the proposed WEBA be rejected. There is no benefit to be gained for ratepayers or the regulatory process by adopting the WEBA mechanism. Further, there is no harm to the investor-owned utilities' financial security if the WEBA is not adopted. A special application is always an option for a utility facing an extraordinary burden such as uninsured costs due to wildfires. The proposed WEBA would not improve the Commission's ability to review significant costs due to a wildfire disaster not already covered in rates. The Commission should retain the "case-by-case" perspective through a memorandum account, or other regulatory mechanism, to deal with unusual circumstances such as excessive wildfire costs.

III. DISCUSSION OF WEBA PROPOSAL

A. Summary of Utility Policy Testimony

For background, the utility policy testimony discusses the major wildfires that struck their service territories in 2003, 2007, 2008 and 2009. The October 2007 wildfires in San Diego County were far the most costly, and Commission investigators found that SDG&E bore some of the responsibility for their ignition.² By 2009, the insurance industry demanded higher insurance premiums for the same or even less wildfire liability coverage. In the meantime, homeowners and others made claims for damages against SDG&E. The damage claims grew larger than the level of SDG&E's total liability coverage of \$1.2 billion.

The utility testimony argues that the risk of uninsured damage claims due to wildfires will increase in the future due several factors: California's dry climate conditions; insurance market volatility; the legal doctrine of strict liability³; and certain service territory characteristics in concert with utility's obligation to serve. The utilities' policy basis for the WEBA proposal is probably best summarized by the following passage:

² See Order Instituting Investigations (OII) 08-11-006 and 08-11-007.

³ Also termed "inverse condemnation" in the Amended Application.

1 When the risk of fire materializes, third parties may assert
2 claims; and when utilities are held liable for such claims, the
3 resulting payments are an unavoidable cost of providing
4 utility service. The utilities are entitled to recover such costs,
5 just as they are entitled to recover all other costs necessary to
6 carry out their mission, as part of the regulatory compact. In
7 exchange for providing utility service under regulated rates,
8 long-standing regulatory policies provide that utilities are
9 entitled to an opportunity to recover their operating costs,
10 plus a reasonable return.⁴

11 **B. Analysis of Utility Policy Testimony**

12 **1. No Current Policy Exists Which Deems Liability Claims** 13 **As Automatically Recoverable**

14 Based on the logic of the utility testimony, uninsured wildfire liability claims,
15 even for instances where the utility was negligent, are recoverable in rates, based on the
16 regulatory compact. This logic is seriously flawed. Nothing in the Catastrophic Event
17 Memorandum Account (CEMA) mechanism permits recovery of liability claims.⁵
18 Further, the general rate case (GRC) ratemaking does not guarantee cost recovery of
19 uninsured claims. Another flaw in the utility policy discussion is the assertion that all
20 costs associated with a wildfire are the result of a natural disaster, subject to an artificial
21 \$10 million threshold. The utility testimony states:

22 Wildfire Claims and Defense Costs up to \$10 million, which
23 will be forecast in GRCs, are not eligible for recovery through
24 WEBA in the Amended Proposal. The occurrence of a
25 wildfire that results in Claims and Defense Costs greater than
26 \$10 million, however, cannot be readily predicted and is not
27 appropriate for test-year ratemaking. Instead, Wildfire Costs
28 associated with such fires should be afforded separate
29 balancing account treatment.⁶

30
31 Under the WEBA proposal, with a demarcation point of \$10 million per wildfire
32 occurrence, test-year ratemaking appears appropriate for wildfires under \$10 million, but

⁴ Amended and Restated Testimony, p. 19.

⁵ See CPUC Code Section 454.9.

1 not appropriate for \$10 million and greater, according to the proposal. But why would
2 test-year ratemaking be appropriate at all, if each wildfire is an unpredictable natural
3 disaster, as the utility discussion would have us believe? Obviously, wildfires do not meet
4 the conditions for CEMA eligibility, or there would be no need for the WEBA proposal.
5 There is no factual or policy basis to apply “the principles embodied in CEMA” to
6 wildfire costs.

7 **2. Current Mechanisms Can Address Future** 8 **Circumstances**

9 Concurrent with the WEBA application were the advice letter submittals by each
10 of the utilities requesting memorandum account treatment of wildfire costs not covered
11 by existing ratemaking but could potentially become eligible for cost recovery under the
12 WEBA proposal. The memorandum accounts were authorized by Resolution E-4311.
13 DRA understands that only SDG&E has a balance in its memorandum account, and that
14 all entries into the account are related to ongoing litigation and settlements associated
15 with the October 2007 wildfires. The balance in the memorandum account currently is
16 relatively small.⁷

17 There is no policy reason or objective served through the WEBA process. Absent
18 the WEBA application and the proposed balancing account, SDG&E has the opportunity
19 to submit a request for memorandum account treatment for excess wildfire costs
20 associated with the 2007 events. As the wildfire litigation process is still ongoing, and
21 may not conclude for years, the final balance in the memorandum account cannot be
22 forecast. When the final balance is known, SDG&E can submit an application for
23 possible recovery.

24 This type of process can be utilized for any similar circumstance involving excess
25 wildfire costs. The Commission, its staff, and intervenors can review and process the
26 request at that time. That process will be far more efficient and transparent than putting

(continued from previous page)

⁶ Id., p. 16.

⁷ SDG&E deemed the memorandum account information confidential.

1 the proposed balancing account mechanism in place. The memorandum account process
2 should also ensure that the utility will be on notice to fully support and justify its request
3 for cost recovery.

4 **3. Cost Recovery and Safety Are Related**

5 The utility testimony argues that the Commission may investigate possible
6 violations of General Orders and therefore “cost recovery and penalties serve different
7 purposes.”⁸ While cost recovery and penalties may serve *somewhat* different purposes, it
8 would be poor policy to pre-determine a *procedural bifurcation* between cost recovery
9 issues and matters of safety and potential violations of General Orders. The Commission
10 should maintain the flexibility to review cost recovery and conduct investigations within
11 the same proceeding. The WEBA proposal would not allow such a scoping.

12 **C. Summary of Utility Cost Recovery Testimony**

13 The utility cost recovery testimony includes some details of the proposed WEBA
14 mechanism. Those details include cost categorization, filing type and timing, balance
15 disposition, and a shareholder reward mechanism. This section also includes a discussion
16 of what is presumably the utilities’ justification for balancing account treatment –
17 drawing parallels to the Energy Cost Adjustment Clause (ECAC) first adopted in the late
18 1970’s. The ECAC mechanism was adopted to address the ongoing fuel and power
19 production costs and associated volatility, and is not remotely comparable to the
20 proposed WEBA.

21 **D. Analysis of Utility Cost Recovery Testimony**

22 **1. Shareholder Compensation Is Unjustified**

23 The utilities propose a shareholder compensation reward through the revenue
24 requirement. The insurance “Premium Rate” should be rejected. The insurance premium
25 cost should continue with cost-of-service, test-year ratemaking treatment.² By definition,

⁸ Id., p. 25.

² Similarly, the insurance premium balancing account treatment should be rejected.

1 test-year ratemaking provides the utility with the incentive to minimize costs and to earn
2 its authorized rate of return. No showing or policy basis is provided in the utility
3 testimony to warrant any type of reward mechanism for insurance costs.

4 **2. Insurance Cost Volatility Does Not Warrant Balancing** 5 **Account Treatment**

6 The primary example provided in the utility testimony – ECAC – is not
7 comparable in scale or scope to insurance costs. As already discussed, the necessity to
8 request recovery of excess wildfire costs could occur on rare occasions, if at all. By
9 comparison, the fuel and purchase power costs of the California utilities are routinely
10 50 percent or more of the annual revenue requirement. As discussed earlier, the recent
11 example of significant wildfire costs are from 2007 and SDG&E has no pressing need at
12 this time to request recovery, and such a request may be several years away.

13 The utilities argue that financial security is another justification for balancing
14 account treatment. This discussion is based on speculation. No real world examples of
15 wildfire costs causing bankruptcy or other serious financial harm to the utilities are
16 provided. The risk placed on a utility that an event such as a major wildfire is part of the
17 risk of operating and maintaining its system in a safe and reliable manner, which in turn
18 provides the opportunity to earn a reasonable rate of return. Balancing account treatment
19 could have a deleterious impact on the utility’s safety practices because the risk for cost
20 recovery may be significantly reduced. The Commission should maintain its mechanisms
21 which promote the best safety practices. The balancing account should be rejected.

22 **E. Summary of Utility Insurance Testimony**

23 The Amended Application presents two types of insurance testimony. First, an
24 insurance broker with experience in utility insurance matters discusses general insurance
25 principles, as well the “Liability Insurance Program Design” that each of the applicants
26 follows in their annual insurance procurement process. Second, each applicant provides a

discussion of their recent annual procurement process. The insurance testimony describes the increases of liability insurance costs between 2008 and 2010 of 15 to 30 percent.¹⁰

F. Analysis of Utility Insurance Testimony

The insurance testimony provides no evidence which warrants balancing account treatment for utility insurance costs. While costs have increased and coverage has decreased in some cases during the period discussed, these matters remain appropriate for test year ratemaking in general rate cases. Similar to excess claims costs, premium expenses should not be converted to a “pass-through” cost. Doing so could remove any incentive for the utility to balance the risk of liability exposure against the implementation of safety measures in a cost-effective manner.

¹⁰ Information regarding 2011-2012 insurance premium costs has not been submitted.

APPENDIX A

1 **QUALIFICATIONS AND PREPARED TESTIMONY**
2 **OF**
3 **SCOTT LOGAN**

4 Q.1 Please state your name and address.

5 A.1 My name is Scott Logan. My business address is 505 Van Ness Avenue, San
6 Francisco, California.

7 Q.2 By whom are you employed and in what capacity?

8 A.2 I am employed by the California Public Utilities Commission as a Public Utilities
9 Regulatory Analyst V in the Division of Ratepayer Advocates Energy Cost of
10 Service and Natural Gas Branch.

11 Q.3 Briefly describe your educational background and work experience.

12 A.3 I received a B.A. in Economics from San Francisco State University in 1985.

13 I joined the Division of Ratepayer Advocates of the California Public Utilities
14 Commission in 1986. I have worked on electricity and energy matters since that
15 time, including energy efficiency, resource planning, long-term procurement and
16 planning (LTPP), transmission planning, Certificate of Public Convenience and
17 Necessity (CPUC) proceedings, and General Rate Cases. I have testified in
18 numerous Commission proceedings. Regarding insurance related matters, I was
19 DRA's lead on SDG&E's Z-Factor proceeding,
20 A.09-08-019.

21 Q.4. What is your area of responsibility in this proceeding?

22 A.4. I am responsible for this Exhibit, DRA's Opening Testimony in A.09-08-020, the
23 Joint Utility WEBA Application.

24 Q.5 Does that complete your prepared testimony?

25 A.5 Yes, it does.